January 1981

An Insurer’s Liability for the Tort of Bad Faith

Steven J. Harman
Associate, Anderson, Brown, Gerbase, Cebull & Jones

Follow this and additional works at: https://scholarship.law.umt.edu/mlr
Part of the Law Commons

Recommended Citation
Available at: https://scholarship.law.umt.edu/mlr/vol42/iss1/3
AN INSURER'S LIABILITY FOR THE TORT OF BAD FAITH*

Steven J. Harman**

I. Introduction .................................... 67
II. Development—The California Decisions ............ 70
   A. Refusal to Reasonably Settle .................. 70
   B. Refusal to Pay the Insured’s Claims ........... 72
      1. Establishment of the First Party Rule ...... 72
      2. Concurrent Coverage/Punitive Damages ...... 73
   C. Extending First Party Claims to Third Party Claims ...................................... 74
   D. Application of the Reasonableness Test ...... 76
III. The Montana Approach .......................... 79
   A. Insurer’s Refusal to Reasonably Settle .... 80
   B. Refusal to Pay the Insured ................... 81
      1. Arising from Contract ..................... 82
      2. A Statutory Action .......................... 83
      3. Mental Distress ............................. 84
   C. Goddard and the Tort of Bad Faith .......... 85
   D. Goddard and Punitive Damages ............... 86
IV. Other States .................................... 89
V. Conclusion ...................................... 91

The appellant [Safeco] relies on several contentions stressing two in particular. One, that the insurance companies are entitled to fair consideration and should not be prejudiced because they are insurance companies. As to this contention we find no merit and will not discuss the same.1

I. INTRODUCTION

Insurance is designed to protect the policyholder from some calamity. In an insurance contract, the policyholder expects prompt action of the insurance company in protecting him from liability to a third person or in indemnifying him for a personal loss. Refusal of the company to act casts the insured adrift at a time when he

* The development of the tort of bad faith in insurance cases is in a state of evolution. The research for this article was ended on October 15, 1980, and does not reflect changes in the law subsequent to that date.
** Associate, Anderson, Brown, Gerbase, Cebull & Jones; B.S., Montana State University, 1972; J.D., University of Montana School of Law, 1975.
particularly needs help. In the not too distant past, if the insured could establish a breach by the company, the insured's damages were determined by what the contract obligated the company to do. Recovery for the insured's anxiety or economic losses could not, under traditional contract principles, be recovered.

To protect the Montana public, the legislature enacted a comprehensive Insurance Code in 1959.4 According to its principal draftsman, the Insurance Code was "designed as a strong, sharp, and sufficiently versatile instrument for the protection of the Montana public interest in insurance, with special facilities for its administration." Included in the new law were provisions prohibiting certain unfair trade practices, including the acts of bad faith,


6. See MCA tit. 33, ch. 18 (1979). The insurance commissioner was given broad powers to investigate unfair trade practices and issue cease and desist orders. In 1977 these statutes were amended to include additional provisions to protect an insured from oppressive tactics of his company in the settlement of a claim, and to provide penalties payable to the state treasury. See 1977 Mont. Laws ch. 320, §§ 1-9 now codified in MCA § 33-18-201 (1979), which enumerate unfair claim settlement practices:

No person may, with such frequency as to indicate a general business practice, do any of the following:

(1) misrepresent pertinent facts or insurance policy provisions relating to coverages at issue;
(2) fail to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;
(3) fail to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;
(4) refuse to pay claims without conducting a reasonable investigation based upon all available information;
(5) fail to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;
(6) neglect to attempt in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear;
(7) compel insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds;
(8) attempt to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application;
(9) attempt to settle claims on the basis of an application which was altered without notice to or knowledge or consent of the insured;
(10) make claims payments to insureds or beneficiaries not accompanied by statements setting forth the coverage under which the payments...
which the Montana court recently recognized as compensable.\textsuperscript{7}

The legislation regulating the insurance industry did not, however, seem to remedy the problems encountered by an insured who was denied insurance benefits. To compensate such an insured, the judiciary in many states created the tort of "bad faith." By evoking this new remedy, an insured could subject an insurer to liability beyond the company's contractual limit. This permitted an insured to recover extra-contractual compensatory damages, and, in some cases, punitive damages, from his insurer for an alleged breach of contract.

Initially, the tort of "bad faith" evolved to establish liability of an insurer for its wrongful refusal to accept a reasonable settlement offer proposed by a third party to compromise a claim against its insured within policy limits. Thereafter, the tort of "bad faith" grew to expose the insurer to liability for extra-contractual damages in processing the claims of its own insured. The former situation is generally referred to as a third party case, while the latter situation is generally referred to as a first party case.

"Bad faith" is, quite simply, the insurer's failure to act in good faith in considering the interests of an insured. Even though the duty to act in good faith does not appear in the express provisions of the insurance agreement, courts in some jurisdictions, notably California, have implied it as a matter of law in every insurance contract. It is the violation of the implied covenant of good faith which gives rise to the tort of "bad faith" and subjects the insurer to liability beyond that for breach of contract. Additionally, the insured may recover general damages, such as those for mental distress.

---

are being made;
(11) make known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration;
(12) delay the investigation or payment of claims by requiring an insured, claimant, or physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information;
(13) fail to promptly settle claims, if liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage; or
(14) fail to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

Decisions in Montana have long recognized the duty of good faith and fair dealing in third party actions. Until recently, the liability of an insurer in a first party situation for extra-contractual damages has been held to arise not from the violation of any duty to act in good faith, but rather from the failure of the insurer to comply with the Insurance Code. However, a recent decision, First Security Bank v. Goddard, suggests that Montana may also recognize a separate tort of bad faith in first party actions.

The purpose of this article is to provide a perspective on the tort of "bad faith." Since California heralded this new claim for relief, particular emphasis will be placed upon its decisions. Montana's unique approach to the problem will be explored in detail. Lastly, the various approaches taken by other jurisdictions will be outlined.

II. DEVELOPMENT—THE CALIFORNIA DECISIONS

A. Refusal to Reasonably Settle

The California Supreme Court first recognized the tort of "bad faith" in Brown v. Guarantee Insurance Co. In that case, the court sanctioned a new claim for relief against an insurer who had unreasonably refused to settle a claim against its insured within its policy limits. Nothing in the express provisions of the insurance contract required the insurer to pay if a demand fell at or under its policy limits, but the court said such an obligation could arise outside the contract from the insurer's implied-in-law duty to act in good faith and deal fairly with its insured. Breach of this legal duty was tantamount to bad faith, which the court concluded was an actionable wrong involving "substantial culpability." Failure to act in good faith could subject the insurer to all damages flowing from the breach, including judgments against the insured in excess of the policy limits.

10. Id. at ___, 593 P.2d 1040 (1979).
12. Id. at ___, 319 P.2d at 75.
13. Id. at ___, 319 P.2d at 77. The court recognized that ordinarily the injured party does not have the right to sue the insurer directly, but such standing was conferred in the case when the trustee in bankruptcy assigned the insured's claim to the injured plaintiff. The court decided not to judge the insurance company's conduct by a standard of reasonableness, concluding, "Negligence alone is insufficient to render the insurer liable." Id. at ___, 319 P.2d at 74.
The California court next expanded the duty to act in good faith where the insurer wrongfully denied coverage and refused to participate in the defense of the insured in *Comunale v. Traders & General Insurance Co.* There a judgment against the insured was obtained in excess of the policy limits after the third party plaintiff offered to settle within the limits. On appeal, the insurer argued that there should be no liability in excess of the policy limits because the company believed there was no coverage. The court recognized that the duty of good faith implied in *Guarantee Insurance* arose from the company's right to control the litigation. In *Trader's General Insurance*, the company did not have this control because it refused to litigate. But the court held that where a company lacks control of the litigation because it wrongfully refused to defend the insured, the company was not excused from its duty to consider the insured's interest in settling the case. The court gave the insured the right to sue in either tort or contract. Therefore, the relief sought extended to compensatory as well as punitive damages.

The *Comunale* decision was reaffirmed in *Johansen v. California State Automobile Association Inter-Insurance Bureau*. In that case, the insurer again denied coverage and refused to accept a reasonable settlement offer. The insured was subjected to a judgment in excess of the policy limits and a suit was brought against the insurer for the excess judgment. The insurer argued against any breach of duty where the company's refusal to settle stemmed from a bona fide belief that the policy did not provide coverage. But the court relied upon language of *Comunale* and held that an insurer's "good faith" belief in noncoverage affords no defense to liability flowing from the insurer's refusal to accept a reasonable settlement offer. Thus, an insurer who chooses to deny coverage

15. Id. at —, 328 P.2d at 201-02. The court recognized a separate basis from which the duty of good faith arose. The obligation to act in good faith implied in every contract stems not only from the right of the insurer to control the litigation, but also from its duty in every case to give at least as much consideration to the insured's interest as it does its own. Id. at —, 328 P.2d at 201.
16. Id. at —, 328 P.2d at 203.
17. 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975).
18. Id. at 16, 538 P.2d at 748, 123 Cal. Rptr. at 292. Failure to undertake the defense of an insured has been held in Oregon to amount to only a breach of contract for which there can be no recovery for mental distress. Farris v. United States Fidelity and Guaranty Co., 284 Or. 453, 587 P.2d 1015 (1978). The court reasoned that in an action for the failure to settle within the policy limits the insurer acts in a fiduciary capacity representing the insured. Violation of that duty amounts to a tort. But where the insurer has not undertaken the duty to represent the insured, it has not assumed a fiduciary duty which can be breached. The insured's remedy therefore is for breach of contract.
is strictly liable for the consequences, including a judgment against its insured in excess of its policy limits.

The use of the deny-at-your-own-peril test articulated in *Comunale* and *Johansen* is a far cry from the "substantial culpability" test imposed by *Guarantee Insurance Co.* The next case, *Crisci v. Security Insurance Co.*, further eroded the standard used to measure "bad faith" in third party situations.

In *Crisci*, the company had a policy limit of $10,000. The insured's attorney advised the company that if the third party plaintiff could sustain its claim, a verdict exceeding $100,000 could be rendered. The company refused to settle for $9,000 and judgment against the insured was ultimately rendered for $101,000. In the insured's action to recover the excess, the company argued that it had acted in good faith in relying on its psychiatric experts to discredit the third party plaintiff's testimony. The court in *Crisci* employed the following test to determine whether an insurer gave consideration to the interest of the insured: "Whether a prudent insurer without policy limits could have accepted the settlement offer." Thus, the negligence test so carefully avoided in *Guarantee Insurance Co.* became the standard in *Crisci* by which the insurer's conduct was to be judged.

**B. Refusal to Pay The Insured's Claims**

1. **Establishment of the First Party Rule**

The third party cases set the stage for the second type of bad faith claim where the company unreasonably withholds money due under the policy. The earliest California decision to consider the

20. In *Guarantee Insurance Co.*, the court presciently avoided this dilemma of putting the insurer in a position where it had to act at its own peril in choosing which witnesses to believe. See 155 Cal. App. 2d at —, 319 P.2d at 74.
21. 66 Cal. 2d at —, 426 P.2d at 176, 58 Cal. Rptr. at 16.
22. Id. at —, 426 P.2d at 178, 58 Cal. Rptr. at 18. The court considered an argument by amicus curiae that a rule of strict liability should be applied against an insurer where a judgment in excess of the policy limits is obtained. Although the court found favor with such a rule because it would eliminate the determination of whether the offer was reasonable, it avoided a decision on the subject by finding evidence that the insurer had acted unreasonably. See Schwartz, *Statutory Strict Liability for an Insurer's Failure to Settle: A Balanced Plan for an Unresolved Problem*, 1975 DUKE L.J. 901. There the author states that the benefits of a strict liability approach include the protection of the insured against economic injury as well as mental suffering where the insurer guesses wrong, and the elimination of potential conflicts of interest which any attorney is confronted with in the defense of an insured. Although there will be additional insurance costs, there will also be some savings inasmuch as costly litigation over excess liability coverage will be eliminated. Id. at 910.
tort of bad faith in the context of first party actions was *Fletcher v. Western National Life Insurance Co.* 23 There the disability insurer falsely claimed that the insured had made a material misrepresentation and then attempted to coerce the insured into a settlement favorable to the company. The insured suffered economic hardship and emotional distress and sued under intentional infliction of emotional distress. The court ruled that the insurer had violated its implied-in-law duty of good faith and fair dealing. In discussing the duty owed, the court reaffirmed the company's general duty not to deprive its insured of the benefits of the policy. 24 Similarly, the court held that the general duty to accept reasonable settlement offers imposed an additional obligation not to maliciously threaten to withhold payments due under the policy for the purpose of injuring the insured. 25 Violation of this new duty sounds in tort as well as in contract. 26

The holding in *Fletcher* was further refined in *Gruenberg v. Aetna Insurance Co.* 27 In that case, the company denied coverage under a fire policy because the insured failed to comply with the policy's cooperation clause by refusing to submit to an oral examination. The court held that the same implied duty of good faith and fair dealing imposed in third party actions applied in cases where the company handled claims by the insured, and that this included a duty not to withhold unreasonably payments due under a policy. 28 Aetna Insurance contended that the duty to act in good faith was conditioned upon the insured's compliance with the express conditions of the policy. The court rejected this argument holding that the duty to act in good faith is an obligation implied-in-law which is not dependent upon the insured meeting the conditions precedent of the insurance contract; rather, the duty is "absolute." 29

2. **Concurrent Coverage/Punitive Damages**

The California Supreme Court examined first party actions for

24. *Id.* at 401, 89 Cal. Rptr. at 93.
25. *Id.*
26. *Id.*
28. *Id.* at 573, 510 P.2d at 1037, 108 Cal. Rptr. at 485.
29. *Id.* at 578, 510 P.2d at 1040, 108 Cal. Rptr. at 488. As the dissent pointed out, if an insurer wants to avoid a bad faith lawsuit, it must pay all claims first and investigate afterwards, assuming payment does not waive the right to investigate it. *Id.* at 592, 510 P.2d at 1049, 108 Cal. Rptr. at 497 (Roth, J., dissenting).
bad faith again in *Silberg v. California Life Insurance Co.* There the insured's policy provided $5,000 worth of medical pay coverage but contained an exclusion for losses caused by injuries for which compensation was payable under Workmen's Compensation. The insurance company denied coverage on the basis of the exclusion, and the workmen's compensation claim was settled two years after the injury for $3,700. The supreme court found no merit in the company's contention that it was entitled to wait until the conclusion of the Workmen's Compensation proceeding before it paid or denied the claim, a practice generally accepted in the insurance field. The insurer's failure under the facts of the case to advance payments for the very contingency insured against violated its duty of good faith and fair dealing. The court held that the company should have paid the claim and then filed a lien against any Workmen's Compensation recovery.

The court granted a new trial on the issue of punitive damages, holding that the requisite intent to injure the insured did not necessarily flow from a violation of the covenant of good faith and fair dealing. Therefore, merely because an insurance company violated its duty to act in good faith, it is not subjected to punitive damages. *Silberg* established that there must be proof beyond that required to establish bad faith of an intent to vex, injure, or annoy to establish a right to claim punitive damages. However, the court's affirmance of compensatory damages again suggests that an erroneous denial of benefits, even accompanied by a good faith belief that they are not owed, subjects an insurer to liability.

C. Extending First Party Claims to Third Party Claims

The California courts have adopted the same standard of care in the first party actions which they had implied in third party cases. Until 1978, no court had discussed why the tort was expanded from third party to first party cases. In *Austero v. Na-

31. Id. at 462, 521 P.2d at 1109, 113 Cal. Rptr. at 717.
32. Id.
33. Id. at 462-63, 521 P.2d at 1110, 113 Cal. Rptr. at 718. The court relied upon CAL. CIV. CODE § 3294 (West 1970) which provides:

In an action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice, express or implied, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant.

Montana's counterpart to this statute is identical. See MCA § 27-1-221 (1979).
34. 11 Cal. 3d 462, 521 P.2d at 1110, 113 Cal. Rptr. at 718.
ional Casualty Co., the court struggled to differentiate the duties owed in each situation.

In Austero the disability insurer refused to pay benefits because it claimed the policy had lapsed prior to the onset of any disability. The insured was an attorney who began to suffer loss of memory in the fall of 1971, but continued routine court appearances throughout 1972 and 1973. After the policy lapsed in 1973 for nonpayment of the premium, a claim was submitted in 1974. The insurer denied coverage because the form filled out by the insured’s doctor contained “does not apply” responses to some of the questions. The jury awarded $67,200 in compensatory damages, which included an amount for benefits for the entire policy period and an amount for mental distress, together with $336,000 in punitive damages.

The court reviewed the decisions on the subject of bad faith and compared the duties owed by an insurer in third party situations with those in first party cases. The obligation to act in good faith requires both parties to the insurance contract not to deprive the other of the right to receive the benefits of the agreement. Third party cases involve a situation where the policy requires the insurance company to pay all sums for which the insured becomes liable because of his own tortious conduct. In addition, the law imposes an obligation to accept reasonable offers by the third party within policy limits as a part of its covenant of good faith and fair dealing. The test of whether the company has acted in good faith is whether a prudent insurer operating without policy limits would evaluate the case as unlikely to produce a judgment for less than the offer. On the other hand, in first party cases, the company agrees to pay money due under the policy upon the happening of certain events. The benefit contracted for is the prompt payment of money upon the occurrence of an event insured against.

The California court recognized that in first party situations the insurer is not required to pay every claim presented to it for such a practice would ultimately drive the insurer out of business. It has a duty to deal fairly with the insured as well as a duty to its policyholders and other stockholders not to dissipate its reserves by the payment of worthless claims. In Austero, the in-

34.1. 84 Cal. App. 3d 1, 148 Cal. Rptr. 653 (1978)
35. Id. at 5, 148 Cal. Rptr. at 656.
36. Id. at 18, 148 Cal. Rptr. at 644.
37. Id. at 28, 148 Cal. Rptr. at 671. Implicit in the denial of coverage is a refusal to entertain reasonable settlement offers and subjects the insurer to liability under the deny-at-your-own-risk rule of Comunale and Johansen.
38. Id. at 30, 148 Cal. Rptr. at 672.
sured’s attorney argued that a test of strict liability should be adopted in first party cases which would subject the insurer to liability should it ultimately be established that benefits were due under the policy, the same approach followed in third party cases in which coverage was denied. Since liability in third party denial of coverage cases was ultimately based upon an unreasonable refusal to settle and not upon strict liability, the court rejected the insured’s contention. Instead, the court applied what it explained had always been the rule in first party cases:

The substance or gravamen of the wrong in these first party cases is an unreasonable refusal to pay benefits due under the terms of the policies . . . . In evaluating the evidence to see if there was any unreasonable conduct by the company, it is essential that no hindsight test be applied.

Because there was no evidence to support a conclusion that the insured acted in bad faith, there likewise was no evidence to support a finding of intent to injure the insured and therefore punitive damages could not be awarded.

D. Application of the Reasonableness Test

Auster marks the first time an insurance company’s conduct was held to be reasonable. Following Auster the California court decided Neal v. Farmers Insurance Exchange and Egan v. Mutual of Omaha, which reiterated the unreasonable conduct test and rejected a strict liability rule. These cases illustrated the imprecise nature of applying a test of reasonableness, and cast some doubt upon whether the judiciary would heed Auster’s mandate and avoid a hindsight test.

The issue in Neal turned on whether the company should have paid the policy’s uninsured motorist benefits. The plaintiff was a passenger in a car driven by her husband and suffered injuries in a collision when her husband attempted a left turn in front of an oncoming uninsured motorist. A legal opinion obtained by the company concluded that the medical pay offset was unclear and that “at best” the case on liability was “50-50.” The plaintiff

40. Id. at 30, 148 Cal. Rptr. at 672.
41. Id. at 31-32, 148 Cal. Rptr. at 673 (emphasis added).
42. Id. at 35, 148 Cal. Rptr. at 676.
44. ___Cal. 3d___, 598 P.2d 452 (1979).
45. 21 Cal. 3d at 919, 582 P.2d at 984, 148 Cal. Rptr. at 393.
initiated arbitration proceedings, which resulted in an award of the full $15,000 in uninsured motorist benefits. The injured wife died sometime after the accident from other causes and her estate then sued on a theory of bad faith.

At the trial, special damages in the amount of $9,573.65 were proven. The jury returned a verdict, with no differentiation between compensatory and punitive damages, in the amount of $1,500,000. The supreme court affirmed the judgment holding that sufficient evidence existed to support the verdict, despite proof that Farmers Insurance merely exercised its legal position reasonably and in good faith. In a forceful dissent, Justice Clark pointed out that the decision amounted to strict liability in first party cases. Punishing the insurer for "guessing wrong" destroys the statutory arbitration procedure, and also forces the insurer to pay frivolous claims, Justice Clark concluded.

In Neal, the court also limited the compensatory damages recoverable in a first party action to those proximately resulting from the breach, such as economic loss or emotional distress. The court said that since the plaintiff sustained her injuries prior to the breach of the covenant of good faith, damages for those injuries could not proximately result from the breach. Therefore, under Neal, an insured cannot recover for pain and suffering or medical expenses usually recoverable in a personal injury case.

Egan v. Mutual of Omaha involved a dispute over the payment of disability benefits. The insured submitted three claims over a period of seven years for three separate back-related injuries, culminating in a fourth claim for back injury in May of 1970. The company then discovered evidence that fifty percent of plaintiff's current symptoms pertained to natural degenerative disease, the rest to the industrial injury. Although the insured claimed he was entitled to lifetime benefits, the company classified the injury

46. Id. at 919-20, 582 P.2d at 984, 148 Cal. Rptr. at 393.
47. The verdict was later cut in half by remittitur. Id. at 920, 582 P.2d at 985, 148 Cal. Rptr. at 394. The facts also disclosed that the insurer had gross assets of $765 million, net assets of $211 million, and a net income of nearly $45 million.
48. Id. at 942, 582 P.2d at 999, 148 Cal. Rptr. at 408.
49. Id. at 941, 582 P.2d at 999, 148 Cal. Rptr. at 408. Regarding the insurer's argument that the punitive award was excessive, the court disagreed, holding that it amounted to less than one week's worth of net income. Id. at 929, 582 P.2d at 991, 148 Cal. Rptr. at 400. In an interesting footnote, the court condemned the award of punitive damages, reasoning that the insurer who was punished deserved to lose business and would do so because the punitive award would require it to raise its premiums to offset the award. Therefore, competing companies would capitalize on that advantage and ultimately punish the recalcitrant insurer by driving it out of business. Id. at 929 n.14, 582 P.2d at 991 n.14, 148 Cal. Rptr. at 400 n.14.
a nonconforming illness and paid only three months benefits. At trial, the insured recovered $45,600 in general damages and $78,000 for emotional distress together with $5,000,000 in punitive damages.\textsuperscript{51}

The supreme court affirmed the compensatory award but reversed the punitive damage award on the grounds that it was excessive. In its opinion, the court relied heavily upon the fact that the company failed to investigate the claim by personally contacting the insured's treating physicians or by having the insured examined by an independent doctor of its choice.\textsuperscript{52}

Justice Clark again dissented, pointing out that the cost of punishing the insurance company for their settlement practices will be passed on to the public in increased premiums.\textsuperscript{53} Contrary to the rationale of the majority in the \textit{Neal} case, Justice Clark stated that the increased premiums are passed on to the general public and not just to the policyholders of the guilty company, because insurance premiums are calculated on industry-wide losses, not on the individual company losses.\textsuperscript{54} Therefore, the plaintiff who obtains a large verdict for punitive damages in reality receives a public subsidy to compensate him for his windfall. Justice Clark concluded that the public should not be burdened with compensating the plaintiff who receives a punitive award, since it would be sufficient detriment to permit the plaintiff to recover damages for mental distress.\textsuperscript{55}

According to \textit{Austero}, \textit{Neal}, and \textit{Egan}, "bad faith" is unreasonable conduct. But as these California cases suggest, the court's definition of "bad faith" is certainly obscure and oversimplified.

\textsuperscript{51} Id. at 817, 598 P.2d at 455, 157 Cal. Rptr. at 485.
\textsuperscript{52} Id. at 816, 598 P.2d at 454, 157 Cal. Rptr. at 485.
\textsuperscript{53} Id. at 825, 598 P.2d at 460, 157 Cal. Rptr. at 490. In this connection Justice Clark stated:

\begin{quote}
Others correctly criticize when the cost of punitive awards may be passed on to the public, resulting in a public subsidy of plaintiff windfalls. Such result, obviously contrary to sound public policy (cf. Gov. Code, § 818 (no punitive damages against a public entity)), is nonetheless risked when punitive damages are awarded against an insurer for deficiencies, in its claims practice. The risk becomes a certainty for mutual insurance companies like Mutual. Because future premiums are based largely on past loss experience and administrative expense in the industry, such premiums can be expected to reflect punitive damages paid by the industry. The public, then, is in the peculiar and indefensible position of penalizing itself with the payment going as unjust enrichment to someone for whom the tort law, through the medium of compensatory damages, already fully provides.\textsuperscript{56}
\end{quote}

\textsuperscript{54} Id. at 826, 598 P.2d at 461, 157 Cal. Rptr. at 491 (citations omitted).
\textsuperscript{55} Id. at 827 n.3, 598 P.2d at 462 n.3, 157 Cal. Rptr. at 492 n.3.
Although the court adheres to the statement that the insurer's conduct should not be judged by any hindsight approach, it appears from the facts of the cases that the court pays mere lip service to such a rule. If the insurer's decision not to pay is erroneous, it appears that the insurer will be liable. At least four principles pertaining to the tort of bad faith have been established in California. First, an insurer's conduct is measured by a test of reasonableness in first and third party cases. Second, whether an insurer acted reasonably should not be judged by a hindsight test, but the size of the verdict permits an inference in third party cases of the value of the claim and whether the insurer should have settled. Third, damages where the insurance company has acted unreasonably include compensatory damages proximately caused by the breach as well as punitive damages where there is evidence of an intent to vex, injure, or oppress the insured. And finally, damages for emotional distress are recoverable without the requisite showing of severity.

III. The Montana Approach

Although "good faith" was defined in an early Montana case, the social need to apply it in insurance cases did not arise until recently. In that early case, the court stated:

Although in its original and popular sense the term "in good faith" denotes honesty of purpose, absence of bad faith, yet it is popularly used to denote the actual existing state of the mind, without regard to what it should be from given standards of law and reason. It does not always require sound judgment and business sagacity.

With respect to an insurer's liability, Montana courts do recognize, at least in third party cases, that there is an implied-in-law duty on the part of the company to act in good faith to protect the interest of the insured. The development of the law of liability of an insurer for refusal to pay in first party cases has not followed the same vein as California, but a recent Montana case, First Security Bank v. Goddard, indicates a willingness on the part of the Montana court to adopt the California approach.

56. As noted at notes 40-41 and accompanying text, Austero may be interpreted as absolving an insurer who reasonably refuses to pay benefits. Austero, 84 Cal. App. 3d at —, 148 Cal. Rptr. at 673.


A. Insurer’s Refusal to Reasonably Settle

The rule subjecting an insurer to liability for its refusal to accept reasonable settlement offers originated in a Montana federal district court decision. In Jessen v. O’Daniel, Judge Jameson held that an attorney’s failure to communicate settlement offers to the insured was a violation of its obligation to act in good faith and subjected the company to liability for a judgment in excess of the policy limits. The court defined the company’s duty as a fiduciary obligation to use ordinary care to protect the insured’s interest as well as its own interest.

Failure to consider the insured’s interest was bad faith and rendered the company liable for its breach of the fiduciary obligation in an amount of the judgment over the policy limits. Error in judgment in not settling a case within the policy limits was not itself sufficient to impose liability upon the company, nor was the mere fact that the company was unsuccessful at the trial. The court articulated standards by which the insurance company’s conduct in considering the interests of the insured is to be judged:

At the outset, the court recognized the obligation on the part of the insurer to exercise ordinary care and diligence in (a) investigating an accident and interviewing witnesses; (b) giving due consideration to applicable law; (c) making adequate preparation for trial; (d) appraising and evaluating the case from a settlement standpoint; and (e) negotiating for a settlement where a fair and honest appraisal of the case requires such action.

Third party cases following Jessen all considered the objective standards by which an insurer’s conduct is to be judged and have found a lack of sufficient evidence to find a violation of the insurer’s obligation to act in good faith. A review of these cases

---

60. Id. at 328.
61. Id. at 319.
62. Id. at 325.
63. Id.
64. Id. at 319.
65. Fetter Livestock Co. v. Nat'l Farmers Union Property & Cas. Co., 257 F. Supp. 4 (D. Mont. 1968). In Fetter the insurer was held not guilty of bad faith for refusing to accept a $43,000 settlement offer, which was well within the $50,000 policy limits, where the evidence revealed that able trial counsel, after a thorough investigation, evaluated the case as being worth $17,000 to $20,000 for settlement purposes. In passing upon the conduct of trial counsel for the insured the court said:

[They] were mistaken in their judgment with respect to what verdict might be returned by the jury. They were also mistaken with respect to the applicable law.

Both courts and attorneys, however, may differ on the law applicable to a given...
reveals that the Montana Supreme Court will not lightly subject an insurer to liability for a judgment in excess of the policy limits, and will certainly not judge the insurer's conduct by a "twenty-twenty hindsight vision" test. In the court's words, "That mistakes, omissions or misjudgments may have been made is apparent; but these do not make bad faith." Thus, according to Thompson, the insurer in third party cases is not judged by a hindsight test, and the fact that the company's judgment was mistaken does not mean it was "wrongful." Instead, the court articulated objective standards which provide a measure of predictability.

B. Refusal to Pay the Insured

Montana has not yet applied the third party standard of reasonableness in first party actions. Instead, an action by an insured against his company for failure to pay insurance benefits subjects the company to liability for damages in the amount of the benefits owed, and if the insured can establish a violation of the Insurance Code to which a criminal penalty attaches, he may then seek punitive damages. The Montana Supreme Court has emphasized punishing an insurance company rather than compensating the insured for his anxiety and economic loss suffered while he establishes his state of facts. In retrospect it is clear that it would have been to the advantage of both the insured and the insurer to have accepted the settlement demand of $43,000. But neither the fact that [the insurer] and its counsel erred in their judgment nor the fact that the defense of the action was unsuccessful is in itself sufficient to impose liability upon [the insurer] for recovery in excess of the policy limits.

Id. at 13.

In Fowler v. State Farm Mut. Auto. Ins. Co., 153 Mont. 74, 82, 454 P.2d 76, 80 (1969), the third party offered to settle for $7,500, policy limits were $10,000, and judgment was ultimately rendered for $20,126.80. The court analyzed the case under the objective standard set forth in Fetter and held there was no evidence of bad faith or negligence on the part of the insurer and reversed the judgment of the district court. In Thompson v. State Farm Mut. Auto. Ins. Co., 161 Mont. 207, 217, 505 P.2d 423, 429 (1973), the court concluded that the insurer did not act negligently or in bad faith by refusing a $9,500 offer of settlement where the limits were $10,000 and an excess judgment was rendered.


67. Id. In Thompson the court implicitly approved an instruction to the jury that bad faith was a "willful failure to respond to a plain and well-understood obligation," yet the court in the same breath stated that negligence and bad faith were synonymous. Id. at 219, 505 P.2d at 430. "Willful" connotes an intentional omission on the part of the insurer, which requires a greater burden of proof than a negligent failure to act, which is a failure to exercise the same degree of care as a reasonably prudent insurer would have exercised. The definition of "bad faith" as a "willful" failure to act is akin to the definition of "substantial culpability" found in Guarantee Ins. Co., 50 Cal. 2d at ___, 319 P.2d at 77.

68. State ex rel. Larson v. District Court, 149 Mont. 131, 423 P.2d 598 (1967).
right to insurance benefits. In order to understand Montana's treatment of the first party case, it is helpful to review the development of the independent cause of action giving the insured a right to sue his company to obtain punitive damages.

Punitive damages are governed by MCA § 27-1-221 (1979):

In any action for a breach of an obligation not arising from contract where the defendant has been guilty of oppression, fraud, or malice, actual or presumed, the jury, in addition to the actual damages may give damages for the sake of example and by way of punishing the defendant.

Analysis of this statute begins with the phrase “arising from contract,” for if an insured’s claim for relief arises from the insurance contract, punitive damages cannot be recovered.

1. Arising from Contract

In Westfall v. Motors Insurance Corp., the supreme court reversed a jury award of punitive damages against Motors Insurance, finding that the claim arose out of a breach of contract. Relying upon California authority, the court stated the general rule that “an award of punitive damages may not be granted in an action based on breach of contract even though defendant’s breach was willful or fraudulent.” Westfall was affirmed in several decisions. In one such case, Judge Russell Smith struck from the complaint a demand for punitive damages where defendant allegedly acted unreasonably and in bad faith by refusing to pay insurance benefits after plaintiff submitted a proof of loss under a property policy. The court reasoned that willful or fraudulent breaches of the contract did not justify an award of punitive damages.

In Ryan v. Ald, Inc., plaintiff claimed that defendant falsely promised that washing machines would be properly installed in good working condition in his new laundromat. Plaintiff alleged that these promises induced him to sign a contract to purchase the equipment. The jury returned a verdict with an award in plaintiff's favor, including $7,500 punitive damages. On appeal, the court re-

69. 140 Mont. 564, 374 P.2d 96 (1962).
70. Id. at 570, 374 P.2d at 99, citing Crogan v. Metz, 47 Cal. 2d 398, 303 P.2d 1029, 1033 (1958).
73. Id.
74. 146 Mont. 299, 406 P.2d 373 (1965).
versed and remanded the case for a new trial. Punitive damages were not recoverable in a case of this kind, the court said, since a fraudulent inducement constitutes an action for breach of an obligation arising from contract. Again the court relied upon Westfall. 75

2. A Statutory Action

A significant exception to the Westfall rule prohibiting punitive damages in cases involving an insurance contract was developed in State ex rel. Larson v. District Court. 76 In that case the plaintiff claimed that the defendant, a disability insurer, had refused to pay benefits in violation of a Montana statute77 which required that disability benefits be paid immediately upon receipt of due proof of loss. The defendant argued that plaintiff’s claim for relief arose from the insurance contract and thus punitive damages were barred under Westfall. The court distinguished Westfall, reasoning as follows:

Making reference to the Westfall case, supra, and to [MCA § 27-1-221 (1979)], [defendant] takes the position that exemplary damages are not proper in any action arising out of a contract obligation. We note, however, that [MCA § 27-1-202 (1979)] provides that every person who suffers detriment from the unlawful act or admission of another may recover from the person in fault a compensation therefor in money, which is called damages. Therefore, if a party can state a claim which brings him under the provisions of [MCA § 27-1-202 (1979)] he can also come within the provisions of [MCA § 27-1-221 (1979)] and attempt to collect exemplary damages.

In the instant case petitioner . . . contends that it was a breach of a contract obligation owed to him, and second . . . that it was a violation of the insurance laws of Montana . . . . Thus, the second contention . . . distinguishes the instant [case] . . . from the Westfall case, supra. 78

75. Ryan, 146 Mont. at 302-03, 406 P.2d at 375.
76. 149 Mont. 131, 423 P.2d 598 (1967).
77. MCA § 33-22-211 (1979).
78. Larson, 149 Mont. at 134-35, 423 P.2d at 600. In Larson, the plaintiff contended that the insurer had violated R.C.M. 1947, § 40-4011 (MCA § 33-22-211 (1979)) which provides as follows:

There shall be a provision as follows: “Time of payment of claims: indemnities payable under this policy for any loss other than loss for which this policy provides any periodic payment will be paid immediately upon receipt of due written proof of such loss . . . .

In citing the statute involved, the court ignored the introductory language “there shall be a provision as follows.” The facts of the case do not disclose
In granting a plaintiff a private cause of action under the Insurance Code, the court effectively created a new cause of action. The argument that the Insurance Code provided remedies exclusively to the insurance commissioner against insurance companies guilty of unfair practices with respect to their insureds was apparently never raised. In *State ex rel. Cashen v. District Court*, the Montana Supreme Court emphasized the limited nature of *Larson* by striking a count for punitive damages from an insured's complaint where the statutes alleged to have been violated did not apply to the case. The court left standing the count for breach of contract.

3. Mental Distress

Since the sufficiency of the pleadings were at issue in both the *Larson* and *Cashen* decisions, neither case considered the type of compensatory damages recoverable for a violation of the Insurance Code. Economic loss as well as emotional distress are the most natural injuries to flow from a denial of insurance benefits. Under Montana law, it is unclear whether a claim for emotional distress arising from the denial of insurance benefits is compensable.

In a case decided prior to *Larson*, Judge Russell Smith reserved ruling on the sufficiency of the bare allegations that the insured parties were entitled to damages for mental distress when the insurance adjuster maliciously accused them of lying and fraud. Nearly a decade later, the same court concluded that an insured could not recover for the anxiety she suffered where the complaint alleged the insurance company was guilty of nothing more than deliberate stalling and an ultimate refusal to pay disability benefits.

The Montana legislature did not sit idly by while all of this judicial regulation of insurance companies was taking place. By 1977 the law of bad faith had been well established in first party actions in California, and *Larson* was nearly ten years old. During the 1977 session the legislature supplemented the Insurance Code with new laws designed to protect the insured from potential un-

whether the policy had such a clause as required by the statute. Assuming the policy contained that provision, then *Larson* can be broadly interpreted to mean that an insurance company commits an unlawful act within the meaning of the general recovery statute not only by failing to include a provision in its policy required by the Insurance Code, but also by refusing to honor that provision once it has been included. Such a result is incongruous.

fair settlement practices of the insurer.\footnote{See 1977 Mont. Laws ch. 320, §§ 1-9, codified at MCA §§ 33-18-101, -201, -210, -1001, -1002, -1004, and -1005 (1979).} MCA § 33-18-201 (1979) contained fourteen subsections which proscribed as unfair practices, among other things, the failure to adequately investigate a claim and failure to attempt in good faith to effect a prompt, fair, and equitable settlement in which liability has become reasonably clear.\footnote{MCA § 33-18-202 (1979).} Furthermore, a more stringent penalty provision was enacted which subjected an insurer guilty of an unfair business practice to a maximum fine of $10,000, payable to the state treasury.\footnote{MCA § 33-18-1005 (1979).}

Presumably, under the Larson doctrine, an insured, aggrieved by conduct of his insurer amounting to an unfair business practice, may also maintain a private action for violation of MCA § 33-18-201 (1979) and seek punitive damages. One wonders if the legislature intended this result, especially since the penalty provision mentions neither a private right of action nor punitive damages. California has held that such a right exists.\footnote{Royal Globe Ins. Co. v. Superior Court, 23 Cal. 3d 880, 592 P.2d 329, 336, 153 Cal. Rptr. 842, 849 (1979). The court recognized an independent cause of action on behalf of an injured third person to sue a tortfeasor's insurance company directly where the complaint alleged that the insurer violated a section of the Insurance Code relating to unfair trade practices. In the case, an injured person sued both the tortfeasor and the tortfeasor's insurer, alleging a violation of Cal. Civ. Code § 790.03 (West 1970). That section provided that it is an unfair and deceptive practice on the part of an insurance company to act knowingly or with such frequency as to establish a business practice which fails to effectuate a prompt, fair, and equitable settlement of the claim where liability has become reasonably clear. Understandably, this case caused much consternation in the insurance community since most people believed that the Insurance Code was intended to provide remedies for the Insurance Comission to use against insurance companies vis-a-vis their insureds.}

C. Goddard and the Tort of Bad Faith

In \textit{First Security Bank v. Goddard},\footnote{-- Mont., 593 P.2d 1040 (1979).} the Montana Supreme Court reviewed for the first time a verdict in a first party action. Although liability in the case was premised upon the statutory violation of the insurer to promptly pay credit disability benefits, the court referred unwittingly to general principles of the tort of bad faith.

The facts were critical to the court's decision and the standard by which an insurer's conduct is to be judged. On October 4 or 5, 1975, John Goddard executed a note, security agreement, and application for credit life and disability insurance in connection with the purchase of an automobile and mailed the instruments to the creditor, First Security Bank of Bozeman. The bank received the
documents on October 7, 1975. Goddard became ill on October 5 and consulted a physician two days later who diagnosed coronary illness and concluded that Goddard's disability began October 5. Goddard made no payments under the note and demanded that the insurer, Bankers Union Life, make such payments. Bankers Union Life refused to make any payments to First Security Bank, relying upon a clause in the policy which excluded disability benefits if the disability resulted from a pre-existing illness.

The district court awarded the bank the amount of the deficiency judgment on Goddard's vehicle and entered judgment for Goddard against Bankers Union Life for the deficiency amount due, plus attorney's fees and a $5,000 punitive award. On appeal, Bankers Union argued that it was entitled to rely upon the exclusion in its policy. In support of its argument, the bank maintained that the insurance was not effective until October 7, 1975, when the bank received the note and application, two days after Goddard's disability commenced. The supreme court disagreed, holding that the intent of the credit life and disability insurance statutes was to make the insurance effective when the indebtedness was incurred. Relying upon authority from other states, the court held that the indebtedness was incurred when Goddard deposited the instruments in the mail, on October 4 or 5, prior to his disability.

With liability firmly established, the court analyzed whether the compensatory and punitive awards were supported by the evidence. Bankers Union contended that since the action sounded in contract Goddard was only entitled to damages for the payments due for the seven months he was disabled. The court rejected this argument holding that the action sounded in tort. The proper measure of damages were "for all the detriment proximately caused by the wrongful act whether it could be anticipated or not." The court held that the "wrongful act" of Bankers Union was the breach of its statutory duty to pay in accordance with the insurance contract.

The court also approved the "legal trend" of punishing an insurer who "willfully" refused to pay a valid claim. Breach of the implied-in-law duty to act in good faith provided a separate basis upon which the court concluded that the conduct of Bankers

87. Id. at — , 593 P.2d at 1042.
88. Id. at — , 593 P.2d at 1045.
89. Id. at — , 593 P.2d at 1046.
90. Id. at — , 593 P.2d at 1047.
91. Id.
Union was "wrongful." The court held that the denial of the claim resulted not from the fact that the disability began on October 5, but from the company's "incorrect" decision that coverage commenced on October 7.

The Goddard decision marks the first time the Montana court implied the obligation of good faith and fair dealing in the context of a first party case. The discussion of bad faith was extraneous since the court confirmed the existence of the insurer's liability on the basis that it violated the Insurance Code. The references to "bad faith" either display a misconception of the tort itself or present the most liberal application of the principles of bad faith yet to be pronounced. Although Montana law recognized that an unreasonable refusal to pay insurance benefits due under a policy constitutes bad faith and no hindsight test is to be used, the court held that the insurer's denial of benefits, under circumstances in which the law governing its conduct was unclear, constituted bad faith. There was no evidence that the company refused to investigate the claim, refused to communicate with the insured, or used oppressive tactics designed to force the insured into a disadvantageous settlement. The insurance company was evidently guilty of nothing more than being wrong. Punishing an insurer for mistaken judgment is tantamount to applying a hindsight test, a test previously rejected by the court. One wonders how an insurer can assess a claim, knowing that if its decision is "erroneous" it will be subject to liability for extra-contractual damages.

D. Goddard and Punitive Damages

In affirming the award of punitive damages, the Goddard court relaxed significantly the proof necessary to establish a right

92. Id. Bankers Union also contended that the award of punitive damages was unwarranted, arguing that there was no criminal penalty directly provided for its failure to pay credit disability benefits, and that there was no proof that its conduct was sufficiently malicious, wanton, or oppressive to support the award. The court rejected both contentions. First, the court held that a general criminal penalty applied to the failure to pay credit disability benefits. Id. at __, 593 P.2d at 1048. Next, the court found that the evidence supported a conclusion that Bankers Union acted with malice. Relying upon established precedent, the court ruled that malice may be implied from the act of "engaging in a course of conduct knowing it to be harmful and unlawful." Id. at __, 593 P.2d at 1048-49.

93. Id. at __, 593 P.2d at 1049 (emphasis added).


95. Goddard, __Mont__, 593 P.2d at 1047.

to such relief. Established precedent required proof of malice be-
yond proof of mere negligence before punitive damages would be
awarded. The Montana court earlier defined "malice" as a "wish
to vex, annoy or injure another person, or an intent to do a wrong-
ful act; malice could be either actual or presumed from all material
facts." Stated another way, the plaintiff was not entitled to puni-
tive damages as a matter of right unless something more than mere
negligence was alleged and proved.

In Goddard, the court relied upon several earlier decisions in
which implied malice had been discussed, to support the award of
punitive damages. In its broadest sense, the Goddard decision
holds that malice will be implied from a statutory violation. In all
of the cases upon which the court relied, knowledge on the part of
the company that it was doing something harmful to the plaintiff,
or evidence of reckless conduct or gross negligence was necessary
before the court would give the issue of punitive damages to the
jury. Yet, in Goddard, the court concluded that since the company
violated a law, a legal determination which was not reached until
the court issued its opinion, the insured was entitled to punitive
damages. Would the same rule apply where a motorist runs a stop
sign and collides with another motorist? Certainly the violation of
traffic regulations are "unjustifiable," according to the present
court.

What the Montana Supreme Court will decide next concerning
the tort of bad faith is uncertain, but from the tenor of the God-
dard decision it appears the court might deviate from its rather
conservative and objective approach followed in third party cases,
and expand an insurer's liability in the first party actions. The
question seems to be not whether the insurance company acted

---

98. MCA § 27-1-221 (1979).
100. In the first case cited by the Goddard court, Ferguson v. Town Pump,
      ___Mont.___, 580 P.2d 915 (1978), the plaintiffs contended that Town Pump knew of a leak
      into their water wells. Because the court found no evidence that Town Pump knowingly
dumped gasoline into the ground, it held that punitive damages could not be awarded. Id. at
      ___, 580 P.2d at 921. In the second case, Miller v. Fox, ___Mont.___, 571 P.2d 804, 808
      (1977), the court held there was a sufficient basis for punitive damages based upon a finding
      that defendant knew when the attachment of property was made that it was wrongful. In
      Cashin v. N. Pac. Ry., 96 Mont. 92, 111-12, 28 P.2d 862, 869-70 (1934), the court held that
      an award of punitive damages was proper where the evidence disclosed the defendant rail-
way, knowing it had caused prior damage, conducted blasting operations near the plaintiff's
home causing injury to plaintiffs. "Unjustifiable" conduct was found in the last case cited by
the court, Cherry-Burell Co. v. Thatcher, 107 F.2d 65, 69 (9th Cir. 1939), from proof that
plaintiff was injured when the car in which he was riding was struck by defendant's car
which was oncoming and attempting to pass another vehicle in a severe snowstorm.
reasonably, but whether it acted correctly. Such a standard departs from one of negligence and approaches strict liability.\textsuperscript{101}

IV. OTHER STATES

The law pertaining to the tort of bad faith in refusal to settle in third party cases is well developed and need not be treated further here.\textsuperscript{102} However, recent first party cases from other jurisdictions deserve some comment. In \textit{Lawton v. Great Southwest Fire Insurance Co.},\textsuperscript{103} the New Hampshire Supreme Court refused to recognize the independent tort of bad faith in a first party case. Although New Hampshire decisions had allowed third party actions in the past, the court reasoned there was no basis to extend the duty recognized in those cases to first party actions. The policy behind third party cases—that the insurer has assumed by contract control over the defense and settlement of claims and is thereby required to exercise good faith to prevent the insured from a judgment in excess of the policy limits—was held inapplicable in first party claims. The court ruled that no basis existed to extend the duty recognized in third party cases to first party claims, and found as insufficient to state a claim for relief allegations that an insurer wrongfully refused to settle a claim with its own insured.\textsuperscript{104} Significant to the court’s determination was its recognition of statutes which protected an insured from unfair trade practices in the settlement of claims.\textsuperscript{105}

In \textit{A.A.A. Pool Services & Supply, Inc. v. Aetna Casualty & Surety Co.},\textsuperscript{106} the Rhode Island Supreme Court likewise deferred to its legislature the determination of whether an insured should

\textsuperscript{101} On Friday, June 27, 1980, plaintiffs Dr. and Mrs. Richard Weber recovered a punitive damage award in a Great Falls district court of $999,000.00 from Blue Cross of Montana on the grounds that Blue Cross had wrongfully refused to pay plaintiffs’ medical claims. Blue Cross had defended on the basis of misrepresentations of the family medical records and that the claims arose out of preexisting conditions. Great Falls Tribune, June 28, 1980, at 1, col. 2. This case is currently on appeal to the Montana Supreme Court.

\textsuperscript{102} See Annotated Bibliography in 1973 Defense Research Institute Monograph Insurance Law—Excessive Liability No. 3 (September 1973) which lists sixty-three law review articles on the subject. For a more recent compendium of cases see Note, \textit{The Widening Scope of Insurer’s Liability}, 63 Ky. L.J. 145 (1975). In Hayes v. Aetna Fire Underwriters, \textsuperscript{—Mont—}, 609 P.2d 257 (1980), the supreme court recognized for the first time that an injured worker could state a claim against his employer’s insurer directly for alleged bad faith handling of the claim. This case marks the first time that an injured person was permitted to maintain an action directly against another’s insurer. See also Vigue v. Evans Products Co., \textsuperscript{—Mont—}, 608 P.2d 488 (1980).

\textsuperscript{103} 118 N.H. 607, 614, 392 A.2d 676, 581 (1978).

\textsuperscript{104} \textit{Id}.

\textsuperscript{105} \textit{Id} at 615, 392 A.2d at 581.

\textsuperscript{106} \textit{—R.I—}, 395 A.2d 724, 726 (1978).
be permitted to maintain an independent action for a bad faith rejection of the insured’s claim. The court was not persuaded by insured’s argument that the policy of insurance was one of adhesion, reasoning that the policy was a standard one, the provisions of which were prescribed by the legislature. The court has since refused to change its position regarding first party claims in a case in which the complaint alleged a bad faith refusal to pay under a homeowner’s policy.107

Deference to legislation was again apparent in the case of Debolt v. Mutual of Omaha.108 There the Illinois Appellate Court stated that an insured who alleged that his insurance payments were delayed, that he was frustrated from obtaining payments, and that he feared for his life, had sufficient remedy for breach of contract and for violation of a statute which provided relief to an insured who was the victim of a vexatious refusal to pay. The court’s conservative nature is apparent from this comment:

[We do not deem the making of law by judicial decree to be a desirable practice per se but should be limited to instances when humanitarian needs dictate the necessity of judicial action or when legislative bodies for an unreasonably long time refuse to enact statutes for the purpose of coping with an enduring problem.109

New York took the same conservative approach in Cosmopolitan Mutual Insurance Co. v. Nassau Insurance Co.,110 the court holding that statutes prohibiting unfair trade practices obviate the need for maintenance of private actions for punitive damages against an insurer engaged in unfair trade practices.

The court in Farris v. United States Fidelity and Guaranty Co.,111 concluded that the damages incurred by the insured whose insurer refused to represent them and denied coverage were limited to damages traditionally recoverable in a contract action. The Oregon court cited legislation similar to that in Montana which provided a civil penalty to the state treasury where an insurer refused to promptly settle claims “in which liability had become reasonably clear,” and concluded that had the legislature intended to enlarge the damages to include compensation for mental distress and punitive damages, it would have so provided.112 Since it did

109. Id. at 17, 371 N.E.2d at 78.
112. Id. at 458, 587 P.2d at 1018.
not, those damages could not be recovered.

On the other hand, many jurisdictions followed the California lead and recognized bad faith as an independent tort.\footnote{113} For example, the Wisconsin Supreme Court recently recognized that the ancillary duty on the part of an insurance company to act in good faith in the settlement of third party claims applies equally when the insurance company is handling a personal claim of the insured.\footnote{114} The elements necessary to establish a claim for bad faith, expressed by the court, leave a doubt as to the nature of the tort. First, the insured must prove that there was not a reasonable basis upon which to deny benefits; second, the insured must prove that the company knew or acted with reckless disregard of this lack of a reasonable basis for denying the claim.\footnote{115} The test is objective: whether a reasonable insurer under the circumstances would have denied or delayed payment of the claim. The negligence standard is the test of the insurer's conduct, yet the court refers to "bad faith" as an intentional tort, which by definition it cannot be.\footnote{116}

V. CONCLUSION

While California courts have created a new tort of bad faith in first party actions, recent decisions from that jurisdiction evidence the difficulty the judiciary is having in articulating the exact nature of the duty owed by the insurer. Although the insurer's conduct is to be judged under a negligence standard as to what a reasonable insurer would have done, the results obtained indicate the


\footnotetext{114}{Anderson v. Continental Ins. Co., 85 Wis. 2d 675, 271 N.W.2d 368 (1978).}

\footnotetext{115}{Id. at 693, 271 N.W.2d at 377.}

\footnotetext{116}{Id. at 691, 271 N.W. 2d at 376. As to damages, the court said that absent proof of intentional infliction of emotional distress, the insured must prove substantial damages apart from the emotional distress itself and the damages occasioned by simple breach of contract. Id. at 695-96, 271 N.W.2d at 378. Punitive damages required proof of an intent to injure, vex, or annoy. Silberg, 11 Cal. 3d at 462, 521 P.2d at 1110, 113 Cal. Rptr. at 718.}
courts may pay mere lip service to such a rule, and equate an insurer's mistaken judgment with a bad faith refusal to pay.

Montana had developed strict objective standards in third party cases against which an insurer’s conduct is to be judged. Yet, in Goddard, the Montana Supreme Court ignored those standards and adopted what may be a strict liability approach. Furthermore, the court relaxed the quantum of proof in a bad faith case required to establish a basis for punitive damages. Such an approach is dangerous and evinces the risks of making law through common law development. Goddard does more to confuse the Montana position than it does to explain it. The Montana Supreme Court has failed to articulate standards which provide necessary predictability in this area. Legislation in the form of the Insurance Code has apparently not accomplished its purpose in protecting the public, yet there is no discussion of any such failure in the decisions. Furthermore, it seems unfair that the burden of spectacular compensatory and punitive awards is paradoxically borne by the public in the form of increased premiums. The ancillary effect of such awards is to coerce insurance companies to pay dubious claims which in turn are paid by others in increased premiums. As one executive of a large insurance company stated: “People with unquestionable claims, and that [is] about ninety-five percent, are not benefited.” It is difficult to justify a substantial windfall to an insured when the cost is passed on to the public.

The future development of the tort of bad faith should be approached cautiously with the rights of both the insured and insurer in balance, in order that the tort will not expand in an obscure fashion, but will be articulated clearly and equitably.

117. Time, September 10, 1979, at 47.